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Report to Congressional Committees

April 1996

ACQUISITION REFORM

Efforts to Reduce the Cost to Manage and Oversee DOD Contracts

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National Security and
International Affairs Division

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Acquisition Reform: Efforts to Reduce the Cost to Manage and Oversee DoD Contracts

April 18, 1996

The Honorable Strom Thurmond
Chairman
The Honorable Sam Nunn
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Floyd Spence
Chairman
The Honorable Ronald V. Dellums
Ranking Minority Member
Committee on National Security
House of Representatives

The Department of Defense (DOD) contracted with the management consulting firm of Coopers and Lybrand to study the impact of DOD's acquisition regulations and oversight requirements on its contractors. In its December 1994 report, The DOD Regulatory Cost Premium: A Quantitative Assessment, Coopers and Lybrand identified over 120 regulatory and statutory "cost drivers" that, according to the contractors surveyed, increase the price DOD pays for goods and services by 18 percent.

As directed by section 363 of the National Defense Authorization Act for Fiscal Year 1996 (P.L. 104-106), we reviewed DOD's efforts to address the cost drivers. Specifically, we developed information on (1) DOD's initiatives to reduce the impact of the cost drivers and (2) the extent to which cost reductions have resulted from DOD's initiatives. We limited our review to the top 10 cost drivers, which accounted for nearly 50 percent of the cost premium identified in the Coopers and Lybrand study.

Background

Coopers and Lybrand, with the assistance of TASC, Inc., performed its study at 10 contractor sites that represented a cross section of the defense industry in terms of size, region, industry sector, degree of participation in the commercial market, and other factors. The study's objectives were to (1) develop and employ an empirically based approach to assess the industry cost impact of specific DOD regulations, (2) measure the overall impact of the DOD regulatory environment on contractors' costs, and

(3) identify key regulatory cost drivers and their impact on contractors' business processes.

The Coopers and Lybrand study used an activity-based costing approach in calculating the impact of DOD's regulations and oversight requirements on industry. Using this approach, Coopers and Lybrand developed cost estimates for the activities and functions resulting from the regulations and oversight requirements instead of generally used cost accounting categories, such as salaries, benefits, and supplies. Coopers and Lybrand determined costs by asking managers at contractor sites to estimate the impact on specific activities of substituting best commercial practices for DOD regulations and oversight.

The top 10 cost drivers identified in the Coopers and Lybrand study were

- DOD quality program requirements (MIL-Q-9858A),
- Truth in Negotiations Act (P.L. 87-653),
- cost/schedule control system,
- configuration management requirements,
- contract-specific requirements,
- Defense Contract Audit Agency/Defense Contract Management Command interface,
- cost accounting standards,
- material management and accounting system,
- engineering drawings, and
- government property administration.

Appendix I describes each of these cost drivers.

According to DOD officials, the Coopers and Lybrand study reinforced the need to continue acquisition reform efforts and served as the framework for specific DOD efforts to reduce the cost of DOD's contract management and oversight requirements.

Results in Brief

In response to the Coopers and Lybrand study, DOD established the Regulatory Cost Premium Working Group to coordinate DOD-wide efforts to address the cost drivers. The working group is tracking many reforms initiated by DOD to reduce the cost of managing and overseeing DOD's contracts.

Although DOD expects substantial savings from reforming its management and oversight requirements, the savings resulting from current DOD initiatives may be significantly less than the 18-percent cost premium identified by Coopers and Lybrand. As of December 31, 1995, contractors seeking to address the cost drivers through DOD's Reducing Oversight Costs Reinvention Laboratory had identified actions that would achieve targeted savings totaling only about 1 percent.

DOD stated that the 1-percent cost savings reported by the reinvention laboratory is based on "work-in-progress" results and that it would be inappropriate to use these results to draw conclusions about DOD's ability to reduce the cost premium. DOD fully expects the savings from laboratory activities to exceed the level reported in December 1995.

DOD Efforts to Address Oversight Cost Drivers

In response to the Coopers and Lybrand study, DOD established the Regulatory Cost Premium Working Group in 1994 to identify and coordinate efforts to address the cost drivers. The working group is addressing the top 24 cost drivers and intends to expand its work to include the top 59 cost drivers identified in the study. The working group finalized an action plan in March 1995 and assigned primary responsibility for addressing the top 24 cost drivers to specific offices within DOD.

DOD initiated a number of reforms, both before and after the Coopers and Lybrand study, to reduce the impact of its regulations and oversight requirements on industry. For example, DOD formed several process action teams to address critical acquisition reform issues. The teams, which consisted of personnel from different DOD functions, military services, and agencies, were responsible for analyzing current practices; identifying costs and alternate approaches; recommending options; and developing measures of success, implementation plans, and new legislative, regulatory, or administrative changes required to implement proposed options. The following teams have issued final reports: Automated Acquisition Information (Apr. 1995), Contract Administration Reform (Feb. 1995), Procurement Process Reform (Jan. 1995), Acquisition Reform Oversight and Review (Dec. 1994), Military Specifications and Standards (Apr. 1994), and Electronic Commerce in Contracting (Dec. 1993).

Some of the recommendations made by the process action teams directly address the cost drivers identified by Coopers and Lybrand. For example, DOD's process action team report on military specifications and standards focused on their impacts on industry and the need to reduce costs

associated with military-unique specifications and standards. In response to the process action team's recommendations, the Secretary of Defense, in June 1994, directed (1) the use of commercial and performance-based specifications and standards instead of military-unique specifications and standards to the maximum extent practicable and (2) the development of a streamlined procurement process to modify existing contracts to encourage contractors to propose nongovernment specifications and industrywide practices. In February 1995, DOD inactivated MIL-Q-9858A (DOD quality program requirements) for new systems. The quality specification is slated for cancellation by October 1996. In the meantime, DOD is encouraging flexibility in allowing contractors to use their own quality systems, which may be modeled on military, commercial, or international standards.

In further emphasizing the need to move away from military-unique requirements, the Secretary of Defense directed DOD in December 1995 to change the management and manufacturing requirements of existing contracts and to unify them within a facility, where appropriate. This initiative is known as the block change or single process initiative.

DOD believes that allowing defense contractors to use a single process in its facilities is a natural progression from the contract-by-contract process of removing military-unique specifications and standards initiated in 1994. DOD expects that moving to common, facilitywide requirements will reduce both DOD and contractor costs in the long term. However, DOD believes that most contractors will incur transition costs that equal or exceed savings in the near term.

In September 1994, DOD established the Reducing Oversight Costs Reinvention Laboratory. This laboratory, which includes the Defense Contract Audit Agency, the Defense Contract Management Command,[1] DOD buying commands, and several DOD contractors, was formed to identify oversight cost drivers, assess if oversight is appropriate based on risk, and identify and implement process improvements to reduce oversight costs. The contractors involved in the reinvention laboratory have proposed a number of changes to DOD's acquisition management and oversight requirements. The areas identified for process improvements include contract cost performance reporting, quality assurance, and government property administration. We are currently reviewing the

[1]The Defense Contract Audit Agency provides DOD with contract auditing services at various stages of the acquisition process. The Defense Contract Management Command provides DOD with assessments of a contractor's operational performance required by contractual terms, conditions, and statement of work.

Reducing Oversight Costs Reinvention Laboratory, and we will issue a separate report on the results of that review later this year.

Savings May Be Less Than Estimated

Although substantial savings are expected from DOD's acquisition reform efforts, the savings from ongoing initiatives to address the cost drivers may be significantly less than the 18-percent cost premium identified by Coopers and Lybrand. As of December 31, 1995, the 10 contractors involved in DOD's Reducing Oversight Costs Reinvention Laboratory had targeted actions to reform DOD's requirements that would, in total, achieve a 1-percent savings. Specifically, even though the value-added base of the contracts at the 10 contractor sites was about $9.6 billion, the contractors estimated that savings of only about $119 million could be achieved by addressing selected DOD regulations and oversight requirements.[2]

One explanation for the disparity between Coopers and Lybrand's 18-percent cost premium and the reinvention laboratory results is that Coopers and Lybrand did not attempt to assess the benefits resulting from the cost drivers it identified. Rather, the Coopers and Lybrand study analyzed only the cost impact of DOD's regulations and oversight requirements on contractors. DOD's Reducing Oversight Costs Reinvention Laboratory identified a significantly lower cost savings potential because some of the cost drivers made good business sense. In addition, contractors would have similar self-imposed requirements in the absence of some of DOD's regulatory requirements. Thus, when the benefits of DOD's management and oversight requirements are considered, the potential to reduce the 18-percent cost premium identified in the Coopers and Lybrand study is significantly reduced.

The Coopers and Lybrand study stated that it did not consider the benefits resulting from DOD's regulatory requirements. It also stated that "those seeking to project the study results to the entire defense industrial base or to estimate in a precise fashion the budgetary savings likely to result from reform of the DOD acquisition environment should exercise caution when interpreting the study results."

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD stated that the 1-percent cost savings reported by DOD's Reducing Oversight Costs Reinvention Laboratory is based on "work-in-progress results" and that to draw

[2]The value-added base of the contracts represents total contract costs less the associated costs of material purchases, including subcontracts.

conclusions about DOD's ability to reduce the costs of managing and overseeing DOD contracts from such early projections is "pure speculation." In addition, DOD stated that since the Coopers and Lybrand study did not attempt to validate the existence of any benefits that DOD may receive from its regulatory requirements, or to quantify the value of such benefits, DOD would not expect that the entire 18-percent cost premium could be reduced to zero. DOD added that it fully expects that laboratory activities will result in cost savings that exceed the 1-percent reported in December 1995. DOD stated that cost savings have not been quantified for many of the process improvement projects currently being worked by the laboratory and that, as laboratory activities mature, other projects will be added.

Our work shows that the actions taken by the reinvention laboratory contractors as of December 1995 have had little success in addressing the cost drivers identified by the Coopers and Lybrand study. We explain in the report that one reason for the difference between the 18-percent cost premium reported by Coopers and Lybrand and the December 1995 results of DOD's Reducing Oversight Costs Reinvention Laboratory is that Coopers and Lybrand did not consider any benefits that DOD may receive form DOD's regulatory requirements. In addition, our discussions with laboratory participants, including DOD and contractor officials in March 1996, indicate that substantially increasing the savings resulting from reinvention laboratory efforts will be difficult in the near term. In fact, 4 of the 10 contractors involved in the laboratory are not actively pursuing development of additional cost savings ideas that would substantially increase currently targeted oversight cost savings.

DOD also suggested we cite the results of one laboratory participant that reported a cost premium of 9 percent and targeted annual savings of 5 percent. Citing the results of only one laboratory while ignoring the other nine would give an inaccurate and distorted picture of the reinvention laboratory's success in addressing the cost drivers identified by the Coopers and Lybrand study.

DOD's comments are presented in their entirety in appendix II.

Scope and Methodology

To develop information on DOD's efforts to reduce the cost of management and oversight requirements, we analyzed DOD's Compendium of Office of Primary Responsibility Reports, which documents the results of research and analyses undertaken by DOD to address cost drivers identified in the

Coopers and Lybrand study. We focused our work on the top 10 cost drivers because they represented nearly 50 percent of the total cost premium identified in the Coopers and Lybrand study. We did not evaluate the quality of the data or analytical work that formed the basis of the Coopers and Lybrand study.

We interviewed and obtained supporting documentation from officials in the Office of the Under Secretary of Defense for Acquisition and Technology, Defense Contract Audit Agency, and Defense Contract Management Command. We also obtained information from representatives of Coopers and Lybrand and TASC to gain insight on the work they performed.

In addition, we obtained information from representatives of the Aerospace Industries Association, Electronic Industries Association, and National Security Industrial Association. These trade associations represent companies that manufacture weapon systems and components for DOD. We also reviewed studies conducted by several public and private organizations on the impact of DOD regulation and oversight on industry.

We performed our review from October 1995 to March 1996 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretaries of Defense, the Army, the Navy, and the Air Force and interested congressional committees. Copies will also be made available to others upon request.

Please contact me at (202) 512-4841 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix III.

Louis J. Rodrigues

Louis J. Rodrigues
Director, Defense Acquisitions Issues

Contents

Abbreviations

DOD	Department of Defense

Department of Defense's Top 10 Cost Drivers

Cost driver	Description
DOD quality program requirements	An umbrella military specification (MIL-Q-9858A) requiring contractors to establish quality assurance programs to ensure compliance with contract requirements.
Truth in Negotiations Act	A statute (P.L. 87-653) requiring contractors to justify cost proposals and proposed contract prices with detailed cost or pricing data that must be certified as accurate, complete, and current.
Cost/schedule control system	A requirement that contractors have an integrated management control system to plan and control the execution of cost-reimbursable contracts.
Configuration management requirements	A military standard (MIL-STD-973) for DOD approval of all contractor configuration changes to technical data packages.
Contract-specific requirements	DOD-imposed requirements that are not codified in statutes, regulations, military specifications, or standards.
Defense Contract Audit Agency/Defense Contract Management Command interface	Costs deriving from daily interaction of contractor personnel with auditors from the Defense Contract Audit Agency and quality inspectors and functional experts from the Defense Contract Management Command.
Cost accounting standards	Requirements for ensuring consistent and equitable allocation of costs and for disclosing accounting practices and contractor interpretation of certain standards.
Material management and accounting system	A requirement (DFARS-242.72) for certain contractors to establish and maintain a system that accurately forecasts material usage and ensures that costs of all materials are appropriately allocated to specific contracts.
Engineering drawings	A guideline (MIL-STD-100E) for preparing engineering drawings.
Government property administration	A requirement (FAR part 45) that contractors assume responsibility for maintaining and accounting for government-owned property.

Note: DOD, Department of Defense; MIL-STD, military standard; DFARS, Defense Federal Acquisition Regulation Supplement; FAR, Federal Acquisition Regulation.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

ACQUISITION AND TECHNOLOGY

0 8 APR 1996

Mr. David E. Cooper
Associate Director, Defense Acquisition Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "ACQUISITION REFORM: Efforts to Reduce the Cost of Management and Oversight of DOD Contracts," dated April 1, 1996, GAO/NSIAD-96-106.

Now on p. 5.

The GAO's conclusion on page 6 that "savings may be less than estimated" is predicated on a preliminary, inter-departmental draft report of the DoD reinvention laboratory's work-in-progress results as of December 31, 1995. To draw such a conclusion from early projections of DoD's efforts to reduce the costs of management and oversight of DoD contracts is pure speculation at best. Given the reported 1995 Defense Acquisition Pilot Program interim results, DoD believes that these efforts continue to hold promise for significant overall cost reductions in the Department.

Specific DoD comments on the draft GAO report are enclosed.

Sincerely,

for Colleen A. Preston
Deputy Under Secretary of Defense
(Acquisition Reform)

Enclosure:
As stated

DRAFT GAO/NSIAD-96-106 DATED APRIL 1, 1996
"ACQUISITION REFORM: Efforts to Reduce the Cost of Management and Oversight of DOD Contracts

DEPARTMENT OF DEFENSE SPECIFIC COMMENTS

Now on pp. 1-2.

Page 2 and 3, BACKGROUND Section

DoD recommends that a proviso be added to this background information discussion of the Coopers & Lybrand Study similar to the statement on page 7. The Coopers & Lybrand Study only looked at the cost portion of the cost/benefit ratio and did not attempt to validate the existence of any benefits that DOD may receive from the regulatory activities or to quantify the value of such benefits.

Page 3, RESULTS IN BRIEF Section, Paragraph 2

The draft report states that although DOD expects substantial savings from reforming DoD's management and oversight requirements, the savings may be significantly less than the 18 percent cost premium identified by the Coopers & Lybrand Study.

DoD recommends that the following additional point be added to this section of the report: Since the Coopers & Lybrand Study did not address the benefit portion of the cost/benefit ratio, DOD would not expect that the entire 18 percent cost premium could be reduced to zero.

Now on p 5.

Page 3, RESULTS IN BRIEF Section, Paragraph 2 and Page 6, SAVINGS MAY BE LESS THAN ESTIMATED Section, Paragraph 1

The draft report states that as of December 31, 1995, contractors seeking to address the cost drivers through DoD's Cost of Oversight Reinvention Laboratory had targeted actions that would, in total, achieve only about a 1 percent savings.

DoD recommends that this statement be revised to reflect the following additional factual information:

- The preliminary data upon which the 1 percent savings was based was provided in a December 31, 1995 work-in-progress report. The lab is in process and DoD fully expects that the lab activities will result in cost savings which exceed 1 percent. For many of the process improvement projects currently being worked by the lab reinvention teams, the cost savings have not yet been quantified. Also, as the lab activities mature, other process improvement projects will be added
- One of the lab sites reports a cost premium of 9% and targeted annual savings of 5%. We are hopeful that other lab sites will achieve this same success.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

David E. Cooper
Clifton E. Spruill
Maria J. Santos
Frederick E. Lundgren
William M. McPhail
Arnett Sanders